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Prospects Analysis of an Islamic Capital Market in Bangladesh

Md. Abul Kalam Azad [α], Mohammad Rokibul Kabir [σ], Faruk Bhuiyan [ρ] & Abdul Kadar Muhammad Masum [ω]

Abstract - Dominant growth of Islamic financial system has ushered in a new era of alternative world economic approach-Islamic Financial System (IFS). It is a well-established fact that Interest (Riba) has negative comportment for an efficient capital market. Greedy intent of making quick buck increases the riskiness of the market. This study ventures deep into full potential of an Islamic Capital Market (ICM) for the flow of funds in Bangladesh. Both the international and domestic challenges are decelerating the opportunities. But, continuous upsurge of Islamic investors and stable market confidence for such market might overcome the snags. The present paper investigates the functioning of Islamic securities and examines the possibilities of their development within the existing regulations and economic determinants in Islamic countries for example Bangladesh.

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I. Introduction

Islamic Capital Market refers to the market where activities are carried out in ways which do not conflict with the principles of Islam. ICM represents an assertion of religious law in the capital market transactions where the market is free from prohibited activities and elements such as riba (usury), maisir (gambling) and gharar (ambiguity). A hectic effort has been put recently on educating western countries on various types of instruments available in the Islamic Financial System. Books, reports, websites and seminars are flourishing. A great deal of marketing has been done by main financial institutions (DB, Calyon) to advertise for their Islamic window. In this sense, the purpose of this research is, therefore, descriptive. This report aims at investigatating opportunities, needs and challenges of an Islamic capital market in Bangladesh.

II. Islamic Capital Market on the Global Front

Global economy has understood the signifycance of Musilm wealth and their perception of investing in accordance with their own ideology by considering the following statistics highlighted by Darmin [1]

- Muslims of the world today are now estimated at more than 1.5 billion, representing a sizeable 24 percent of total world population of 7 billion.
- Latent Islamic funds in global financial institutions is said to be at US$1.3 trillion while the Islamic financial market is estimated at US$230 billion in size, with an annual growth rate of 12-15 percent.
- There are over 250 Islamic financial institutions currently operating in about 75 countries worldwide, with more than 100 Islamic equity funds managing assets in excess of US$5.0 billion.

Today, the Islamic financial market runs parallel to the conventional financial market and provides investors with an alternative investment philosophy that is rapidly gaining acceptance. In addition, Islamic financial market does not prohibit participation from non-Muslims that creates unlimited upside to the depth and breadth of this market.

III. Proposed ICM Products for Bangladesh

a) Investment Deposit Certificates (Kuwait Finance House and Sudan Islamic Banks)

Kuwait Finance House (Kuwait) has issued three types of Investment Deposit Certificates. Profits are computed annually after deduction of actual maintenance and overhead expenses at the rate of 2.5 percent of annual returns. In this case, investment is made for an unspecified period of time. The investor is free to dispose of the certificates through sale or alienation, on the condition that he enters that in the records of the Kuwait Finance House [2].

In Sudan, Islamic banks, namely, Faisal Islamic Bank of Sudan, Sudan Islamic Bank and the Islamic Cooperative Development Bank, issue "Investment Deposit Certificates" are totally interest-free. The holder of the certificate authorizes the issuing party to utilize the certificates in the way that serves the benefit of both parties (i.e. the holder of the certificate as the fund provider and the Bank as a mudarib: entrepreneur).

b) Muqaradah Bonds (Jordan)

These bonds are issued by the Ministry of Endowments and Islamic Affairs and Sanctities in Jordan [3]. A muqaradah bond is an instrument of a fixed value issued in the name of its holder against the amount of money he has contributed towards the

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implementation of the project with the aim of making profitable investment. The instrument is transferable to a third party under intimation to the issuing party which thus registers the transfer of title.

c) Islamic Transactions Certificates (Egypt)

These bonds are issued by the Islamic Transactions branches of Bank Misr (Arab Republic of Egypt) for a nominal value of 1000 Egyptian pounds (or US dollars) and their multiples. The bond is nominal and is issued for a term of five renewable years. The prospectus of these bonds states that they are to be invested in Islamic projects and that the bank is mandated to act on behalf of their holders in determining the appropriate methods of investment, on the basis of unlimited mudarabah rules.

d) IDB Investment Certificates

These are investment certificates issued for financing trade among Islamic countries. They may also be used to finance certain other operations for specific purposes including leasing. Each certificate has a nominal value of one thousand US dollars and a term that is linked to the portfolio term, which is 25 years. The liability of the certificate holders including the Bank is limited to the value of the rights of each in the portfolio.

e) Participation Term Certificate (Pakistan)

These certificates are financial instruments issued by banks and financing institutions in Pakistan. These are negotiable certificates based on the principle of profit and loss sharing and aim at mobilising medium and long-term financial resources in the local currency for industrial and other projects. Ismail [4] explains an issue of Pakistan that issued a statutory law governing all legal matters related to these certificates,

Furthermore, the participation certificate holders have the right to transfer a certain part of their certificates into ordinary shares of the issuing company. The regulations also stipulate that the issuing party may grant shareholders the right of purchasing participation term certificates.

f) Investment Council Unit Fund Certificates – Bangladesh

These certificates are issued by the Investment Council in Bangladesh which is a governmental non-banking financing institution operating mainly on interest basis. However, the authority also arranges the establishment of unit funds operating on the basis of mudarabah. Each fund is totally independent in terms of assets and liabilities and has its own independent management. The funds' resources are mobilised together through the sale of the above mentioned certificates which are known under the names: ICB Unit Certificates and ICB Mutual Certificates [5].

g) Qard Hasan Certificates (Interest-freeloan) – Malaysia

Qard Hasan certificates are short-term certificates issued by the Malaysian government by virtue of a parliament decree, in order to obtain interest-free loans from banks, institutions and private individuals. This is the concept of Qard Hasan (interest-free loan) advocated by the Islamic shari'ah [6].

Such certificates will have an expansionary effect without generating inflationary tendencies from which most developing countries are now suffering.

IV. Shari'ah View of Current Islamic Securities

With regard to various Islamic securities viewed earlier- on the basis of mudarabah contracts, we shall now direct our attention to [7].

a) Clarifying certain rules concerning the application of the mudarabah terms in the field of securities,

b) Reviewing some of the shari'ah objections faced by the securities currently on the market.

Some Rules Relating to the Application of Mudarabah Conditions in the Field of Securities

i. An Islamic security may be issued on the basis of absolute or conditional mudarabah. In the case of absolute mudarabah, security holders grant their unconditional consent to the issuing party to utilise their funds in all fields of investment conforming to the shari'ah.
ii. There ought to be a specific date for calculating operating results and distribution of realised profits and specification of profit sharing rates between the issuing party -- as a mudarib (responsible for actual management of the project) whether wholly or partially -- and the holders of the securities as financiers and project owners. A typical example of these certificates is the securities issued by the Jeddah-based Islamic Development Bank and made available to businessmen in Islamic countries to finance foreign trade and other operations.
iii. In case of losses incurred by projects or operations financed through securities, the party in charge of actual management (the mudarib) may be able to meet the loss out of the financial reserves retained from profits realised in earlier periods. The security holders, being the capital owners, would have to meet any loss incurred just as they reap realised profits.
iv. Any omission of the conditions relating to profit and loss as well as any ambiguity in prescribing these conditions in the prospectus is considered as a violation of the mudarabah contract. It may

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be noted that the prospectus of the IDB portfolio is very detailed and accurate in this respect, whereas in some other cases no details are given as to what can be expected in case of loss as if this possibility were totally ruled out. This is likely to raise a great deal of suspicion.

v. It must be pointed out here that the issuing party is bound by shari'ah to uphold the conditions under which the securities were issued whether it is acting as the end-user or just an agent for these accumulated securities.

vi. It is also to be noted that in all cases the project or the investment activity financed through securities has its own financial entity as distinct from that of the issuing party. It follows then that the property or assets of the issuing party are totally distinct from those of the project or the investment activity financed through securities [8].

Some Shari'ah Objections against Islamic Securities: Review and Comments

a) Shari'ah Objections to the Jordanian Muqaradah Bonds

i. Some criticism is raised against the use of the word "bond" to describe these financial instruments. A bond is defined in civil law as a perpetual debt on the issuing party commanding a fixed periodical return agreed upon on the date of issue which is a usurious interest.

ii. The law on the basis of which the muqaradah bonds have been issued does not sanction any right to bond holders with regard to the project ownership. Rather, it holds in trust the amounts they have paid which it returns to them at their value at the date of redemption. The Jordanian government guarantees the full settlement of the nominal value of the bonds on maturity.

iii. Muqaradah bond holders get their share of any realised profits. However they are not bound, as they should have been according to their status as fund providers in muqaradah contracts, to any commitments in the absence of profits, which mean that they do not incur losses. This is no doubt in conflict with the mudarabah contract which necessitate that fund providers should share profits when realised and should bear losses when incurred, whatever the amount, out of the principal.

b) Shari'ah Objections to the Participation

Term Certificates (PTC) of Pakistan: Due to certain similarities between the PTC of Pakistan and bonds transacted in the western markets, doubts have arisen as to the shari'ah permissibility of the PTCs. Mohamed [9] explains the issue of "guarantee" for the certificate's nominal value gives rise to objections on the same grounds mentioned in the previous section on the Jordanian muqaradah bonds. It may be argued that this arrangement was meant to provide a guarantee for the certificate holders in case the project using their funds fails to observe the terms of the mudarabah contract. However, this is not clearly stated in the available prospectus of such certificates.

c) Objections to the Investment Fund Certificates – Bangladesh [10]

Objections raised in this case are not related to the technique itself or the terms of issue, but rather to actual practices pertinent to utilisation of the resources mobilised through these certificates. Such resources are generally invested in profit generating activities, but any surplus funds are deposited with conventional banks and earn interest. Such a practice, naturally, is not Islamic, and whatever interest is realised through it, and distributed among the certificate holders, is not halal (shari'ah accepted) money. Some would even question the profits realised through investments in certain projects.

d) Doubts Surrounding the Certificates of Bank Misr Branch for Islamic Transactions

The Islamic transaction branches of conventional banks have been open to doubts and polemics regarding the seriousness of their Islamic financial transactions. Some hold the view that these branches are nothing more than fictitious windows opened for the sake of attracting savings of Muslims not wishing to deal with interest, and then to use these savings, along with other resources that may be accumulated by the bank, in conventional banking operations. The advocates of this view vindicate it through theoretical proofs based on the nature of banking activities and their methods of mobilising resources [11].

V. Islamic Capital Market in Bangladesh

In the context of the present development processes all contemporary Muslim countries combined with the endeavour to revive the application of shari'ah, In fact, these projects depend at the inception of their activities either on private individual financing and subscriptions from relatives and friends or on financing from Islamic banks. It may also be noted that some Islamic banks have already taken this step of getting into the financial market and have issued medium or long term securities in order to establish a new financing source that would enable them to respond to the needs of projects seeking growth. This trend is expected to increase in near future.

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Among these conditions is the one that requires the shari'ah-based economic activity to attain a degree of maturity to produce a favourable climate for bringing about "external surpluses" required for its sustenance. Muslim countries should have the capability to translate the relevant part of the Islamic shari'ah into the form of essential regulations and systems that would contribute to setting up a secondary stock market capable of meeting the challenges of our modern life [12].

These conditions may be realised in part or full in the foreseeable future in some Muslim countries that have some experience in the activities of stock markets and a strong Islamic economic movement. Based on the above, we find that the establishment of an Islamic secondary stock market will not come about as a natural development at present. In fact, what is required is to make preparations for this market through Islamic studies regarding its laws, regulations, objectives and functions.

It may also be noted that the success of establishing an Islamic secondary stock market and ensuring its survival and growth in the long run will not depend only on a good organisational structure to run its affairs and Islamic legislation to safeguard it, but also on the employment of human expertise and know-how that are Islam-oriented to perform its duties and to have peculiar characteristics that would distinguish it from the conventional stock markets [1].

VI. Recommendations

The best securities to a Muslim are those issued --

a) by ventures serving the objectives of Islamic economic activity,

b) projects expected to yield higher returns,

c) the Muslim buyer who acquires them will not feel embarrassed to take advantage of price changes through the sale of securities in his possession or repurchasing them later on for the benefit of achieving windfall profits from this transaction.

Preconditions of an Islamic capital market in Bangladesh -

Above critical understanding of available information suggests the following preconditions for ICM in Bangladesh:

a. Facilitating expansion of products and services in Islamic capital market

b. More effective mobilisation of Islamic funds

c. Strengthening tax, accounting and regulatory framework for ICM

d. Enhancing international value recognition of ICM

e. Sound economic and market fundamentals are important for instilling greater confidence among investors

f. Funds to be invested in markets complying with principles of securities regulations

And the master plan for the utmost result whish has proposed by Aggarwal and Yousef [13].

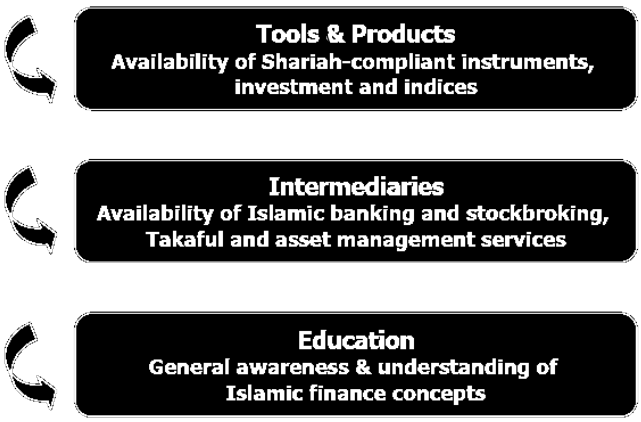


Figure : Principle Components of Successful Islamic Capital Market

VII. Conclusion

In order to underscore the need for an Islamic stock market, let us ask about the alternative in case it is not set up or no efforts are made to establish it. That probable alternative would be nothing but to continue to deal in the Islamic securities in the present stock markets in Muslim countries according to the existing rules and systems. Such a practice will be faced with many obstacles, unbalanced advantages and uncalculated competition with interest-based securities, or securities issued by companies and institutions uncommitted and indifferent to the issues of *halal and haram*, thus leading to continued weakening of the tide of financing of shari'ah-based investment projects. This can only be achieved when the shari'ah-based investment projects realise actual success and go on expanding. There is a further step that is more ambitious and an advance towards the target. That step is to endeavour to adjust and develop the present rules governing the dealings in stock markets in the Muslim countries.

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